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SUBJECT: OPPOSITION GROWS AS PARLIAMENT DEBATES CONTROVERSIAL OYU  
TOLGOI COPPER MINE DEAL

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REFTEL A) ULAANBAATAR 216 B) 06 ULAANBAATAR 773

11. (SBU) SUMMARY: The Government of Mongolia (GOM) has begun its public roll-out of the tentative investment agreement for the development of the Oyu Tolgoi copper mine struck between the GOM and Ivanhoe/Rio Tinto in April (ref A). If copper's price remains at today's high of US\$7,600 per ton, Mongolia would receive US\$71 billion (2006 total GDP amounted to US\$2.8 billion) and Ivanhoe Mines/Rio Tinto will get US\$62 billion. Having joked privately that "we will be lucky if only 80% of the public opposes the plan", chief GOM negotiator Ministry of Finance State Secretary Khurelbaatar is anxious to shepherd the deal through to cabinet and parliamentary approval with minimal public agitation before the State Great Hural's (parliament) summer recess at the end of July. Ivanhoe, silenced by a non-disclosure clause in the agreement, has reacted to perceived missteps and misstatements about the deal "with mouths bloodied from biting our tongues so hard," according to their reps.

Although the deal has not yet produced street demonstrations on the scale of those held in January 2006, a small but vocal groundswell of opposition has begun to congeal, led mostly by civil society organizations such as the Open Forum, environmental NGOs, a scattering of MPs and, most vocally, by the self-promoting MP and erstwhile sacked Health Minister L. Gundalai, who, in a recent one-man press conference, called the deal "crap." END SUMMARY.

12. (U) On July 9, Ch. Khurelbaatar, State Secretary of Finance and chief government negotiator on the investment agreement, held a press conference to publicly present the tentative deal between Ivanhoe/Rio Tinto and the GOM over development of what many believe to be the world's largest copper mine; Oyu Tolgoi, in the south Gobi desert. Seizing the initiative, Khurelbaatar and team presented the plan in its best light before the expected pummeling it will receive in parliamentary debates and the press over the next few weeks.

Parliament is expected to take up the debate on the Oyu Tolgoi deal on Tuesday, July 24th. Mongolia's cabinet approved the deal on June 26th.

13. (U) Khurelbaatar stressed that the agreement will be valid for 30 years and that employment terms would force the companies to lean in favor of local labor; 50:50 Mongolians/foreigners for the first five years, 70/30 for the subsequent seven years, and 90:10 thereafter. Mongolia stood to reap at least US\$15.5 billion over the 30 year span from the development if copper prices fell to a conservative estimate of US\$2,425 per ton, US\$21 billion if copper averaged US\$3,000 and \$31 billion if it hovered at US\$4,000. If the price were to remain at today's high of US\$7,600, Mongolia would receive US\$71 billion and Ivanhoe Mines will get US\$62 billion. (Note: To provide some perspective Mongolia's total GDP last year was US\$2.8 billion.)

14. (U) In an interview with the press a few days later, Minister of Finance Bayartsaikhan noted that the investment agreement on Oyu Tolgoi was a tremendous improvement over past agreements and would prove to be exponentially more profitable for Mongolia. He said Mongolia would own 34% of OT "free of charge" (Note: this is an exaggeration as the deal would have the GOM deferring profits until its investment share in the mine has been effectively paid for) and explained that Ivanhoe and Rio Tinto would receive a five year exemption from paying the Windfall Profits Tax (WPT) but that they would pay all other taxes in accordance with Mongolian law. He reiterated that the OT deal could drive up Mongolia's national GDP by over 30% per year.

15. (U) Critics highlighted what they consider to be major faults with the plan. The Open Society Forum (OSF), formerly the George

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Soros Foundation, published a list of seven questions it felt the parliament should investigate before approving the plan. OSF questioned the "government take" figures listed by Khurelbaatar and called for a more thorough auditing of the plan before parliament could make an informed decision. Ivanhoe has done the analysis, they claimed, but refused to release the information. OSF also asked if financial or environmental assurances were provided should Ivanhoe and/or Rio Tinto sell their shares to Chinese or Russian mining companies. Finally, OSF said the agreement was simply an extra-legal way to rewrite the minerals law of 2006.

16. (U) Critics are united in condemning Ivanhoe's exemption from paying the windfall profits tax (ref B) that would levy a 68% tax on copper profits if the international price were over US\$2,600 per ton. The agreement has Ivanhoe investing in infrastructure to smelt copper inside Mongolia (instead of presumably shipping it to China for smelting), thereby avoiding the WPT, but the OSF called it a poor trade off for Mongolia. They claim that even at copper prices well below current levels, the lost revenue from the WPT in the five years before a smelter is built (the period in which the WPT would apply under present law) could be several billion dollars, perhaps twice the entire capital cost of the smelter. Mongolia, they said, should build the smelter itself and pocket the change, although they did not specify how Mongolia would find the needed investment funds equivalent to a couple of year's worth of total GDP.

17. (U) OSF questioned the need to build a smelter at all in Mongolian territory. "Smelters produce little additional employment and can create serious environmental problems through emissions of arsenic, sulphur dioxide, dust and carbon monoxide. Given the hazards, Mongolia may be better served to keep its WPT and let its market, China, bear the environmental costs of smelting." Supporters of the plan contend that revenue from the WPT would disappear, leaving Mongolia with nothing, if copper prices were to fall but that a smelter would ensure a constant flow of returns.

18. (SBU) Among the several civil movement organizations that have expressed opposition to the OT deal, none has been more vocal (nor more attention-seeking) than MP L. Gundalai of the "Healthy Society Citizens Movement" and creator and head of the Mongolian Popular Party. Gundalai, dismissed from his post as Health Minister earlier this year because his self-promotional antics had proved an

embarrassment for the government, has been working overtime to stoke the fires of controversy around the OT deal in hopes of resurrecting his own faltering political prospects. He has made no secret of his desire to become President of Mongolia. On July 18, he called a one-man press conference where he denounced the OT deal as "crap" and called for a sit-in strike on Sukhbaatar Square that started on July 19th. Shortly thereafter civil movement organizations including the Mongolian Democratic Movement declared their willingness to join him. The first day of protests failed to attract a large crowd. A small but violent demonstration on July 20 in front of Ivanhoe's offices resulted in angry protestors overturning one of the company's mini-buses and hanging a sign over it that read, "Oyu Tolgoi is public property!"

Comment: Will the GOM and Parliament Blink?

19. SBU) Comment: OT negotiations were stalled for three years, sometimes due to Ivanhoe's missteps and sometimes because politicians cowered before even modest protests. Recently it appeared that momentum and popular sentiment had shifted to favor the conclusion of a deal, as the public had heard much about Mongolia's "vast mineral resources" and they wanted returns to begin sooner rather than later - to get on with it. The issue is whether Mongolia will get its "fair share," a concept open to interpretation and exploitation by populist politicians. All eyes are now watching

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to see if parliament will approve the deal within the next couple of weeks or if opposition groups will again succeed in blocking or delaying it. Approval could spell an unprecedented economic boon for Mongolia as investment agreements on other mineral developments come on-line in rapid succession using OT as the template. On the flip side, if a vote on the agreement is pushed back into the fall session, the odds of its survival in its current form will drop dramatically, according to local analysts, (and hinder development of the country's overall mining sector for years to come) as politicians begin posturing before mid-2008 parliamentary elections. There is also some risk that major western firms will conclude that Mongolia is just not yet ready for "prime time," possibly abandoning the field to unscrupulous Chinese or Russian firms. END COMMENT.

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